



Economic Update

HOUSE COMMITTEE ON THE BUDGET
Majority Caucus • Jim Nussle, *Chairman*

309 Cannon House Office Building
www.budget.house.gov • (202) 226-7270

Volume 1, Number 8

11 December 2002

Soft Labor Market Persists in 'Moderate' Recovery

The U.S. economy continues to search for traction in its recovery from the slowdown and recession of 2000-2001. Although recent data showed real gross domestic product [GDP] rising at a 4-percent annual rate in the third quarter, the underlying rate of growth is not strong enough to generate significant growth in jobs or a sustained reduction in the unemployment rate (especially with productivity gains at high rates). Although some indicators suggest the weakness is fading in key sectors – including labor markets, manufacturing, and business construction – it remains unclear when those markets and sectors will show a sustained rebound.

In addition, the President this week presented two new nominees to his economic team – one for Secretary of the Treasury, and the other for Chairman of the Securities and Exchange Commission. A new White House economic advisor is expected to be named soon, as well.

Recent Data

Recent data indicate that the overall economy is continuing to grow at a slow to moderate pace, although specific sectors and markets, including manufacturing and labor, are largely stagnant. (It should be emphasized that the trends over time provide far more reliable indicators of economic conditions than does any individual monthly figure, such as the November jump in the unemployment rate.)

- The unemployment rate rose to 6.0 percent in November, matching the recent April high following the recession. Over the past year, the unemployment rate has persisted in the 5.5-percent to 6.0-percent range.
- Nonfarm payroll employment declined by 40,000 jobs in November, with private payrolls falling by nearly 50,000 for the

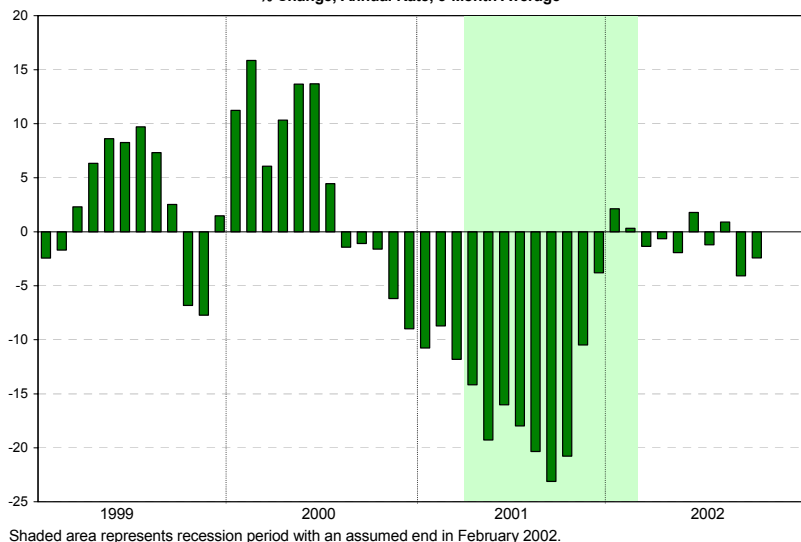
second month in a row. The level of private payroll employment has changed little following the 2.2-million job loss from February 2001 to March 2002.

- The manufacturing sector continues to struggle; the Institute for Supply Management's purchasing managers index [PMI] was at 49.2 percent in November (a value below 50 indicates the manufacturing sector is contracting). Manufacturers' shipments of nondefense capital goods – a key measure of equipment investment spending – have shown little improvement this year following the large declines registered from the middle of 2000 through the end of 2001 (see chart below).

Nevertheless, some indicators are beginning to suggest a trend toward better performance:

- Real private nonresidential construction spending – which has declined 30 percent during its steady downward trend over the past year and a half –

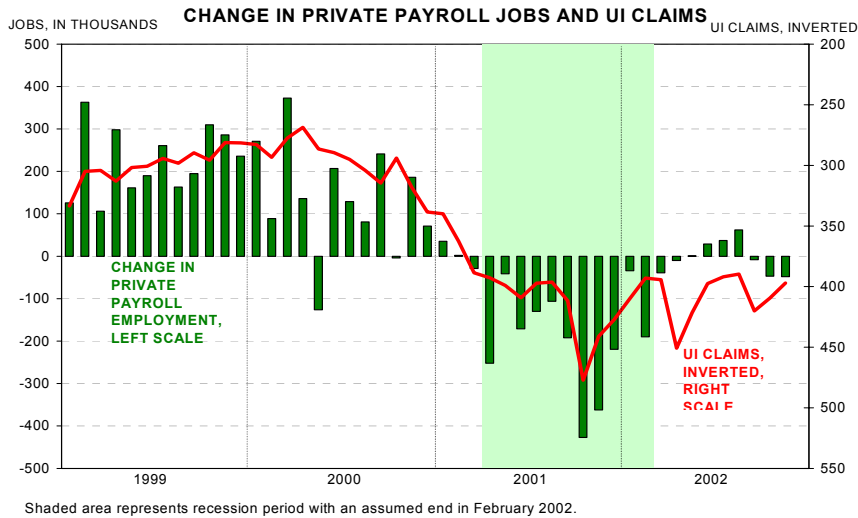
MANUFACTURERS' SHIPMENTS, NONDEFENSE CAPITAL GOODS
% Change, Annual Rate, 3-Month Average



(continued on reverse side)

registered a small gain in October. Business construction investment has been a key source of weakness in the economy this year, so any improvement – even just a halt in the decline – is welcome.

over 3 percent and the unemployment rate only gradually declining, to a rate of about 5.6 percent by the fourth quarter of next year. The table below shows a summary of the December Blue Chip consensus forecast.



- Unemployment Insurance [UI] claims have trended downward in recent weeks and months, suggesting some improvement in labor markets. The close relationship between the performance of UI claims and the change in private nonfarm payroll employment (see chart above) suggests that continued improvement in UI claims would bode well for job growth prospects. (Note that the spike in UI claims in the chart in early 2002 was related to the extension of unemployment insurance compensation.)
- Productivity growth continues at high rates. In the third quarter, labor productivity (output per labor hour) in the nonfarm business sector rose at a 5.1-percent annual rate. Over the past year, productivity grew at a 5.6-percent annual rate – and real hourly wages grew at a 1.7 percent rate. Such high gains in productivity are good signs for continued growth of real wages and are indicative of the good underlying fundamentals for U.S. economic performance. But these productivity gains also contribute to the lag in employment recovery even as the economy is growing.

The Blue Chip Forecast

Private forecasters generally expect the pattern of moderate economic growth and sluggish job market performance to continue over the next year with real GDP growth at just

The key changes from the November Blue Chip forecast were 1) the lower Treasury bill interest rate projection following the Federal Reserve's decision to cut interest rates in November (a decision left unchanged at the Fed's meeting this week); 2) the upward revision in real GDP growth in the third quarter – to 4.0 percent from the earlier reported advance estimate of 3.1 percent; and 3) a downward revision in projected real GDP growth in the fourth quarter, to 1.4 percent from last month's rate of 1.6 percent. The projection for real GDP growth during 2003 was unchanged at 3.3 percent.

The expected downward shift in GDP growth from the third to the fourth quarter reflects a retrenchment of consumption, following its third-quarter surge. This has been a recurring pattern in the current recovery, owing in part to special factors such as low-interest financing for new car sales.

The President's New Appointments

The President this week named two new nominees for his economic team. They are John W. Snow, chief executive officer of CSX Corporation, to be Secretary of the Treasury; and William H. Donaldson to be chairman of the Securities and Exchange Commission. The President is expected soon to name a new White House economic advisor, as well.

Blue Chip Economic Outlook, December 2002

	2002.1	2002.2	2002.3	2002.4	2003 Avg.
	(percent)				
	----- (History) -----				
Real GDP Growth	5.0	1.3	4.0	1.4	3.3
Unemployment Rate	5.6	5.9	5.7	5.8	5.8
CPI Inflation	1.4	3.4	1.8	2.3	2.1
3-month Treasury Bill	1.7	1.7	1.7	1.4	1.7
10-year Treasury Note	5.1	5.1	4.3	4.0	4.5

Note: For 2003, rate of change is for 4th quarter 2002 to 4th quarter 2003; annual average levels for unemployment and interest rates.